You hang up the phone. Finally, the Wells submission worked, and there is no enforcement proceeding against the company. That was painful — about $2 million and some unpleasant disclosures. Now, it is time to settle scores. What was the name of that jerk who started all of this? There was zero substance to it. Surely, the law can't protect an employee who makes unsubstantiated claims of wrongdoing. Damn the torpedoes, full speed ahead!

# Whistleblowers and Retaliation: The New Chamber of Horrors

BY JOHN K. VILLA

Hold on, mate. There's trouble out there.

Anti-retaliation provisions in many state and federal statutes have traditionally provided protection to employees who act as whistleblowers. Recent federal legislation, moreover, has significantly expanded these protections, making retaliation an even more dangerous avenue to pursue, especially in cases involving alleged breaches of the securities laws. And this is true even if the information provided by the whistleblower leads nowhere in terms of enforcement activity. Is there no justice?

## Background of whistleblower protection laws

Whistleblower statutes have a remarkably long history,[1] as do provisions within these statutes that ensure employee protection against retaliation. For more than 25 years, for example, employees have been able to obtain redress against their employers for adverse actions taken after reporting particular types of employer wrongdoing, such as wage and hour violations,[2] workplace safety violations,[3] or violations of the environmental laws.[4] Similarly, since the mid-1980s, the False Claims Act has enabled employees who report fraud in connection with government contracts to seek redress for retaliatory actions taken by their employers.[5] Recovery under these statutes, which authorize either direct civil actions by an aggrieved employee against the employer,[6] or administrative and/or judicial proceedings brought by the Secretary of Labor,[7] has generally included not only reinstatement with back pay, but also awards for reasonable attorneys' fees and litigation expenses.[8]

In 2002, following the corporate financial scandals that began to unravel in the fall of 2001, Congress extended whistleblower protections to employees of publicly-held companies to encourage the reporting of suspected fraudulent conduct.[9] Under the statute as originally enacted by the Sarbanes-Oxley Act (SOX),[10] 18 U.S.C.A. § 1514A, an employee suffering discrimination or an adverse employment action as the result of either reporting violations of certain statutory or regulatory prohibitions against fraud, or participating in any proceeding relating to an alleged violation of these prohibitions,[11] has been entitled to recover "all relief necessary to make the employee whole."[12] Like many of the other whistleblower statutes administered by the Department of Labor, the employee must first initiate an administrative claim with the department,[13] which, if successful, entitles the claimant to reinstatement to the seniority status that she would have had, but for the retaliation; to back pay, with interest; and to compensation for litigation costs, expert witness fees and reasonable attorney fees.[14]

While potentially broad in scope[15] and capable of producing substantial recoveries,[16] the whistleblower protections under Section 1514A, as originally enacted, have not resulted in a significant number of retaliation claims: Of the claims filed and concluded, only a small percentage have been favorable to whistleblower employees reporting alleged instances of fraudulent corporate conduct.[17] Some attribute this to employee reluctance, procedural limitations,[18] or the construction accorded the statute at the administrative or judicial level.[19] Whatever the cause, recent amendments to Section 1514A, and the enactment of new statutes providing more incentives and protections for corporate whistleblowers, is likely to encourage both whistleblower claims and recoveries, and present difficult "retaliation" issues.

For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act,[20] enacted in 2010 in

JOHN K. VILLA is a partner with Williams & Connolly LLP in Washington, DC. He specializes in corporate litigation (civil and criminal) involving financial services, directors', officers' and lawyers' liabilities, securities and related issues. He is an adjunct professor at Georgetown Law School and a regular lecturer for ACC. He is also the author of *Corporate Counsel Guidelines*, published by ACC and West. He can be contacted at jvilla@wc.com.

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response to the most recent financial crisis, extends the coverage of Section 1514A to a broader class of employees, including employees of nationally recognized statistical rating agencies protected against retaliation under the statute,[21] and employees of private subsidiaries of publicly-traded companies where the financial information of the subsidiary is included in the parent's consolidated financial statements.[22] Dodd-Frank also eases some of the procedural limitations existing under the original version of the statute — first, by lengthening the time period for filing a retaliation claim,[23] and second, by explicitly providing employees with the right to a jury trial should de novo review be available in federal court.[24] Finally, and perhaps most significantly, Dodd-Frank prohibits the waiver of any rights or remedies under Section 1514A through the use of any type of employment agreement, including pre-dispute arbitration agreements.[25] As recently construed by one court, this prohibition applies retroactively to conduct predating the amendment of the statute.[26]

In addition to bolstering the whistleblower protections under SOX, Dodd-Frank also expands protection to employees of both public and private companies who report suspected violations of other laws, including any federal securities law.[27] Section 922 of the Act adds new Section 21F to the Securities Exchange Act of 1934,[28] which not only encourages the reporting of suspected securities law violations through an incentive award program, but also prohibits employers from retaliating[29] against whistleblowers "because of any lawful act done by the whistleblower[,]" including any of the following:

- providing information to the SEC in accordance with new Section 21F;
- initiating, testifying in, or assisting in any investigation or judicial or administrative action of the SEC based upon or related to such information; or
- making disclosures required or protected under SOX, the Securities Exchange Act of 1934, section 1513(e) of Title 18, "and any other law, rule, or regulations subject to the jurisdiction of the Commission."[30]

Unlike SOX, new Section 21F provides whistleblower employees alleging retaliation with a direct right of action against their employers, and a considerably longer period within which to bring such an action.[31] In addition, Section 21F entitles a prevailing whistleblower with somewhat greater relief: reinstatement with the same seniority status that the whistleblower would have had, but also relief for the retaliation, and compensation for litigation costs, expert fees and reasonable attorneys' fees, including an award for two times the amount of back pay, with interest.[32]

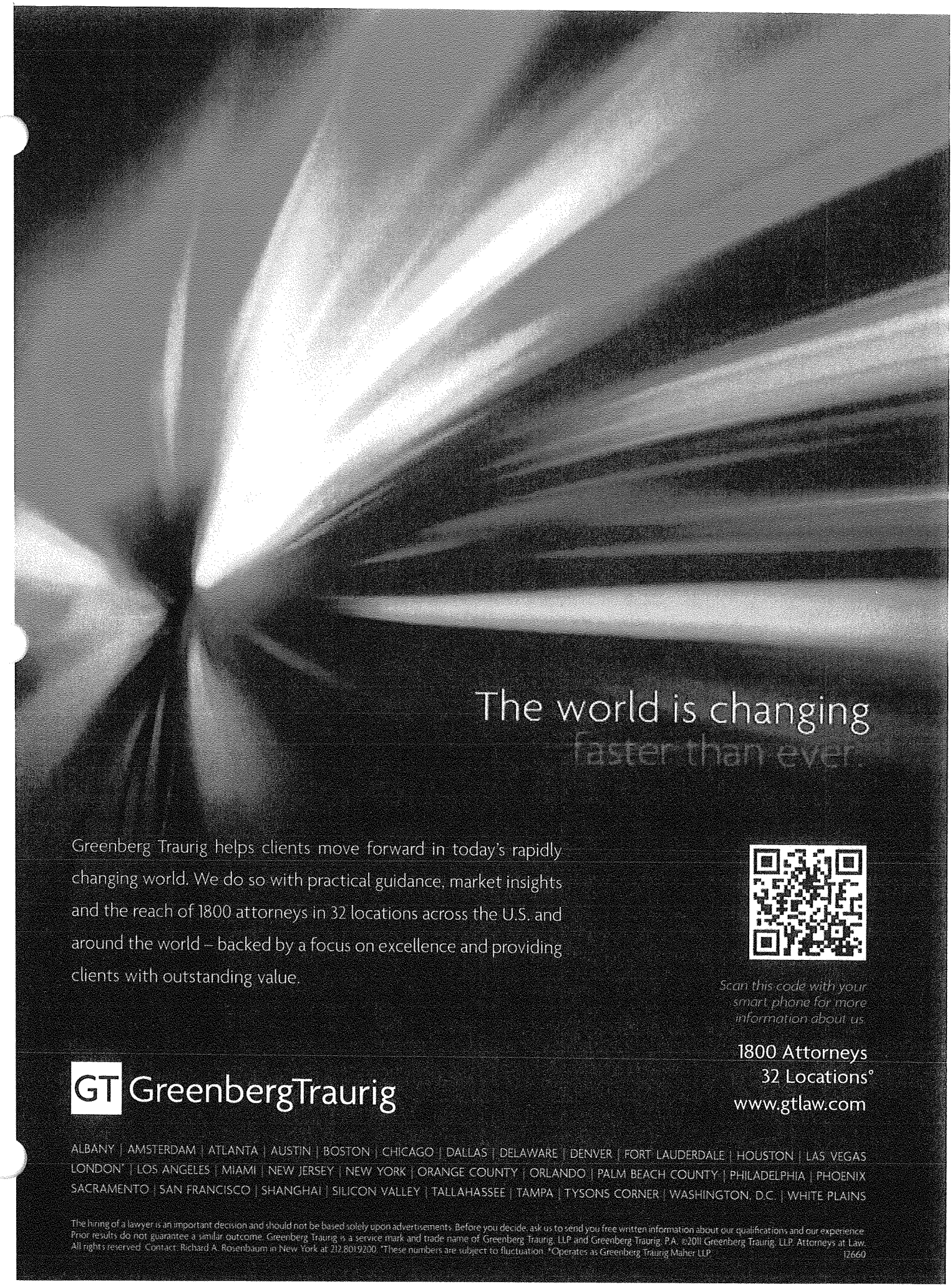
## New Dodd-Frank regulations

In regulations recently issued in implementation of Section 21F, the SEC has attempted to clarify the application of both the anti-retaliation protections of the new statute and its incentive or bounty award provisions.[33] After first providing a general definition for the term "whistleblower" — an individual, acting alone or jointly, who provides the SEC with information relating to a possible violation of the securities law pursuant to procedures set forth later in the regulation[34] — Rule 21F-2 then provides a two-prong standard for establishing eligibility for protection under the statute: To be considered a whistleblower for purposes of the anti-retaliation provisions, an individual must (1) possess a reasonable belief that the information provided relates to a possible securities law violation or to a possible violation of SOX, 18 U.S.C. § 1514A, "that has occurred, is ongoing, or is about to occur," and (2) provide that information in a manner set forth in Section 21F(h)(1)(A) of the statute.[35]

As explained by the SEC in the release accompanying issuance of the new rule, the first prong imposes a "reasonable belief" standard that "requires that the employee hold a subjectively genuine belief that the information demonstrates a possible violation, *and* that this belief is one that a similarly situated employee might reasonably possess."[36] According to the SEC, a "reasonable belief" standard appropriately balances the need to encourage the provision of "high-quality tips without fear of retaliation," and the need to discourage abuse of the anti-retaliation protections through the submission of bad faith or frivolous reports.[37]

The second prong, the SEC explains, "reflects the fact that the statutory anti-retaliation protections apply to three different categories of whistleblowers," the third of which "includes individuals who report to persons or governmental authorities *other than the Commission.*"[38] Thus, employees of public companies making a report pursuant to Section 1514A of SOX, which is incorporated into the third category under Section 21F(h)(A), will be protected under the anti-retaliation provisions of Section 21F(h) when, in accordance with Section 1514A, they report to a federal regulatory or law enforcement agency, to a member or committee of Congress, or to a supervisory employee with authority to investigate or terminate misconduct.[39] Missing from this list is protection for those who make "disclosure" to a plaintiff's lawyer for filing civil litigation against the employee's company — a crucial point of contention.

In addition to prescribing eligibility standards for coverage under the anti-retaliation provisions of Section 21F, the new rule also makes clear that the

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protections apply even if the whistleblower fails to "satisfy the requirements, procedures and conditions to qualify for an award" under the bounty provisions of Section 21F.[40] To predicate protection on the receipt of an award, the SEC explains in the release, "could unduly deter whistleblowers from coming forward with information."[41] Moreover, such an approach would not protect a whistleblower "[even] if he or she provided accurate information about the employer's violation, but for some reason no successful Commission action was brought" or no payment was awarded.[42]

Finally, the rule provides that the SEC has the authority to enforce the anti-retaliation protections of Section 21F in any action or proceeding brought by the Commission.[43] As explained by the SEC, the codification of Section 21F within the Securities Exchange Act provides the SEC with enforcement authority for violations of the anti-retaliation provisions of the new statute.[44] The SEC further explains that this factor — Section 21F's codification within the Securities Exchange Act — also supports the conclusion that employers may not require employees to waive or limit the anti-retaliation protections under Section 21F. Thus, even though there is no express provision in Section 21F relating to the waiver of the whistleblower protections through the execution of employment agreements, such as pre-dispute arbitration agreements, Section 21F is covered by other provisions of the Securities Exchange Act which specifically prohibit agreements to waive compliance with any provision of that Act or any rule or regulation promulgated under the Act.[45]

As the SEC's regulatory release makes clear, the anti-retaliation protections of Section 21F(h) have a potentially broad reach and pose a significantly greater risk to employers than previously existed under federal law. To date, only one court has addressed the application of Section 21F in a decision rendered before the SEC's promulgations of Rules 240.21F-1 *et seq.*

### *Egan v. Tradingscreen, Inc.*

In *Egan v. Tradingscreen, Inc.*[46] — an action by a former employee against his employer, its affiliate and its CEO — the defendants moved to dismiss the action for failure to state a claim under the whistleblower provisions of Section 21F. Noting that it was presented with an issue of first impression in the federal courts, the court initially ruled that a plaintiff must establish that he reported the alleged securities law violation in accordance with the categories set forth in the statute, i.e., that the information was reported to the SEC or that it was one required to be reported or protected under the categories set forth in Section 21F(h)(A)(iii).[47] Finding that the complaint failed to allege that the disclosure fell within the latter categories, the court then focused on whether it sufficiently alleged that the plaintiff reported a violation to the SEC. Where it did not allege that the plaintiff personally reported the information, it alleged that the plaintiff made the report to attorneys retained to investigate the reported violations, and further alleged that, based on information and belief, those attorneys reported the violation to the SEC. As construed by the court, the plain text of the statute permits a plaintiff to act alone or jointly with others in reporting violations to the SEC.[48] In the absence of regulations providing further guidance on what constitutes sufficient reporting to the SEC under the anti-retaliation provisions of Section 21F,[49] the court found that the complaint adequately pleaded that the plaintiff acted jointly with the outside attorneys in an effort to provide information to the SEC regarding the alleged misconduct,[50] and granted the plaintiff leave to amend the complaint to plead facts supporting his knowledge, previously alleged on information and belief, that the misconduct was reported to the SEC.[51]

Although decided before issuance of the final rules, the *Egan* court's determination that a plaintiff must allege that he made a report in accordance with one of the categories set forth in the statute comports with the SEC's final rules imposing such a requirement on a whistleblower seeking protection under the anti-retaliation provisions.[52] As to the court's ruling regarding joint action in reporting a violation to the SEC, the new regulations do not provide further guidance on this issue in the context of the anti-retaliation provisions, but merely restate the statutory definition of a whistleblower as one who acts alone or jointly in reporting to the SEC.[53] While the regulations generally define whistleblowers as those who report to the SEC pursuant to procedures set forth later in the rules,[54] specific provisions expressly exempt whistleblowers seeking anti-retaliation protection from satisfying the requirements, procedures and conditions necessary to qualify for an award.[55]

With new and expanded protections now available for whistleblower employees, companies should tread carefully when dealing with an employee who has reported alleged wrongdoing by the company. Despite the issuance of regulations attempting to clarify and distinguish the bounty and anti-retaliation provisions of Section 21F, questions undoubtedly will still arise in applying the anti-retaliation protections to corporate employees. How courts will continue to construe and apply these protections in light of the implementing regulations remains an open question.

*Editor's Note: For complete endnotes, visit the* Digital Docket *version.*

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NOTES

1 For example, the False Claims Act, 31 U.S.C. §§3729 *et seq.*, which encourages employees through the payment of incentive awards to report fraud in connection with a company's receipt or payment of funds from or to the federal government, dates back to the 1860s. See S. Rep. 99-345, accompanying Pub. L. No. 99-562, 100 Stat. 3153 (Oct. 27, 1986) (Federal Claims Act Amendments Act of 1986).

2 See Fair Labor Standards Act of 1938, ch. 676, § 15, 52 Stat. 1068, codified at 29 U.S.C. § 215(a)(3) (prohibiting retaliation against an employee for instituting a complaint alleging violations of the Act); 29 U.S.C. § 216(b), added by Pub. L. No. 95-151, § 10(a), (b), 91 Stat. 1252 (Nov. 1, 1977) (authorizing recovery for retaliatory actions taken against an employee in violation of 29 U.S.C. § 215(a)(3)).

3 See 29 U.S.C. § 660(c), enacted by Pub. L. No. 91-596, § 11, 84 Stat. 1602 (Dec. 29, 1970).

4 See, e.g., 42 U.S.C. § 7622, enacted under the Clean Air Act Amendments of 1977, Pub. L. No. 95-95, Title III, § 312, 91 Stat. 783 (Aug. 7, 1977); 42 U.S.C. 9610, enacted under the Comprehensive Environmental Response, Compensation, and Liability Act, Pub. L. No. 96-510, Title I, § 110, 94 Stat. 2798 (Dec. 11, 1980).

5 31 U.S.C. § 3730(h), added by Pub. L. No. 99-562, 100 Stat. 3153 (Oct. 27, 1986). Aside from any recovery in a retaliation suit, whistleblowers whose reports of fraudulent conduct result in a successful action against the contractor are entitled to recover incentive payments amounting to a certain percentage of the amount recovered from the contractor. See 31 U.S.C. § 3730(d). Under amendments to the False Claims Act made by the Fraud Enforcement and Recovery Act of 2009, contractors, subcontractors and agents may bring suit under the statute as whistleblowers and need not be in a strict employment relationship with the alleged wrongdoer; in addition, the fraud need only involve federal funds and need not involve a government agency. See Pub. L. No. 111-21, § 4, 123 Stat. 1617 (May 20, 2009).

6 See, e.g., 29 U.S.C. § 216(b) (employee has right to bring retaliation action against employer, but such right terminates upon filing of complaint by Secretary of Labor seeking legal or equitable relief on behalf of employee).

7 See 29 U.S.C. § 660(c)(2) (employee reporting safety violation may file retaliation complaint with Secretary of Labor who, after investigation, may file action in district court against employer); 42 U.S.C. 9610(b) (setting forth administrative grievance procedures for employees whose reports of environmental violations by their employers have resulted in adverse employment actions).

8 See, e.g., 29 U.S.C. § 216(b) (employee suffering adverse employment action for reporting wage and hour violations entitled to "such legal or equitable relief as may be appropriate to effectuate the purposes of [the statute]," including reinstatement or promotion, lost wages, plus an additional amount equal to the lost wages as liquidated damages for attorneys' fees and costs); 29 U.S.C. § 660(c) (court authorized to order "all appropriate relief including rehiring or reinstatement of the employee to his former position with back pay."); 42 U.S.C. § 9610(b) (Secretary of reinstatement of the employee ... to his former position with compensation."), and (c) (at the request of the applicant, an order of abatement may include costs and expenses, including attorneys' fees, that have been reasonably incurred in connection with the institution and prosecution of the proceeding).

9 See S. Rep. No. 107-146, at 19.

10 Pub. L. No. 107-204, § 806, 116 Stat. 745 (July 30, 2002).

11 Statutes and regulations specified in the statute include the federal mail, wire, bank, and securities fraud statutes (18 U.S.C. §§1341, 1342, 1344, 1348), regulations of the SEC, or any federal law relating to fraud against shareholders. 18 U.S.C.A. § 1514A(a)(1).

12 *Id.* at § 1514A(b).

13 *Id.* However, if the Secretary of Labor does not issue a final decision within 180 days following the filing of the claim, and there is not showing that the delay is the result of bad faith of the claimant, the whistleblower may bring an action for de novo review in the appropriate federal district court with jurisdiction over the matter. *Id.*

14 *Id.* at § 1514A(c).

15 Some courts have ruled that SOX should be broadly construed because of its purpose: "to promote corporate ethics by protecting whistleblowers from retaliation." *Sharkey v. J.P. Morgan Chase & Co.*, No. 10 Civ. 3824, 2011 WL 135026, at *5 (S.D.N.Y. Jan. 14, 2011) (citing *Mahony v. Keyspan Corp.*, No. 04 Civ. 554, 2007 WL 805813, at *5 (E.D.N.Y. Mar. 12, 2007)). Applying such a construction to the statute, one court has held that an employee who is fired after reporting fraudulent conduct by a client of her employer falls within the protections of SOX. *Sharkey v. J.P. Morgan Chase & Co.*, 2011 WL 135026, at *6.

16 See, e.g., OSHA, *Regional News Release: US Labor Department Orders Tennessee Commerce Bank to Reinstate Whistleblower and Pay More Than $1 Million in Back Wages and Other Relief* (March 18, 2010), available at *www.osha.gov/pls/oshaweb/owadisp.show_document?p_table=NEWS_RELEASES&p_id=17283* (finding that bank retaliated against employee for raising concerns about internal controls, employee accounts, insider trading and other issues). Some courts have held that recovery in a whistleblower case under SOX may also include damages for reputational injury to the extent that the retaliation diminished the claimant's future earning capacity. See *Jones v. Home Fed. Bank*, No. CV-09-CWD, 2010 WL 255856, at *6 (D. Idaho Jan. 14, 2010); *Hanna v. WCI Communities, Inc.*, 348 F. Supp. 2d 1332, 1334 (S.D. Fla. 2004).

17 According to one report, as of mid-April of 2009, only 1,400 whistleblower claims had been filed under SOX since its enactment in 2002, and, of these claims, employees prevailed in only 230 cases, including 210 settlements, while employers prevailed in 930 cases. Laurence Moy, Linda Neilen, and Katherine Blostein, *Whistleblower Claims Under the Sarbanes-Oxley Act of 2002*, 1756 PLI/Corp. 573, 578 (Sept. – Dec. 2009); *see also* Richard E. Moberly, *Unfilled Expectations: An Empirical Analysis of Why Sarbanes-Oxley Whistleblowers Rarely Win*, 49 Wm.& Mary L. Rev. 65, 65-67 (Oct. 2007) (reporting that in the first three years following the enactment of SOX, only 3.6 percent of employees won relief through the administrative process, and only 6.5 percent won relief through the appeals process).

18 As originally enacted, retaliation claims had to be filed within 90 days after the alleged retaliation. 18 U.S.C.A. § 1514A(b)(2)(D) (2002).

19 One commentator has suggested that strict construction and, in some instances, misapplication of SOX's whistleblower protections have contributed to the low success rate for corporate whistleblowers. Moberly, 49 Wm. & Mary L. Rev. at 67.

20 Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

21 18 U.S.C.A. § 1514A(a), as amended by Pub. L. No. 111-203, § 922(b), 124 Stat. at 1848.

22 *Id.*, as amended by Pub. L. No. 111-203, § 929A, 124 Stat. at 1852.

23 *Id.*, § 1514A(b)(2)(D), as amended by Pub. L. No. 111-203, § 922(c)(1)(A), 124 Stat. at 1848.

24 *Id.*, § 1514A(b)(2)(E), added by Pub. L. No. 111-203, § 922(c)(1)(B), 124 Stat. at 1848.

25 *Id.*, § 1514A(e), added by Pub. L. No. 111-203, § 922(c)(2), 124 Stat. at 1848.

26 *Pezza v. Investors Capital Corp.*, __F. Supp. 2d__, 2011 WL 767982 (D. Mass. 2011) (denying defendant's motion to compel arbitration, and finding that "[i]n the absence of clear legislative intent to limit the temporal reach of Section 922 of the Act and given the procedural — as opposed to a substantive — character of Section 922," the court, rather than the arbitration panel, had jurisdiction over the plaintiff's whistleblower claim.).

27 Pub. L. No. 111-203, § 922(a), 124 Stat. at 1841-1849. The Act also provides incentives and whistleblower protection to employees who report suspected violations of the commodities laws, see *id.* at §748, 124 Stat. at 1739-1746, as well as protections for employees who report violations of the laws governing consumer financial products and services. *id.* at § 1057, 124 Stat. at 2031-2035.

28 *Id.*, § 922(a), 124 Stat. at 1841-1849, to be codified at 15 U.S.C.A. § 78u-6.

29 Retaliation covers a range of conduct — discharging, demoting, suspending, threatening, harassing, either directly or indirectly, or otherwise discriminating against the whistleblower in the terms and conditions of employment. *Id.*, § 922(h)(1)(A), 124 Stat. at 1845-1846, to be codified at 15 U.S.C.A. § 78u-6(h)(1)(A).

30 *Id.*

31 *Id.*, § 922(h)(1)(B), 124 Stat. at 1846, to be codified at 15 U.S.C.A. § 78u-6(h)(1)(B) (action must be commenced either within six years from the date of the violation of the anti-retaliation provisions, or, within three years from the date when the employee knew or should have known of facts material to the right of action, but in no event later ten years from the date on which the violation occurred).

32 *Id.*

33 See Securities and Exchange Commission, *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*, Release No. 34-64545, available at *www.sec.gov/rules/final/2011/34-64545.pdf*. The rules will be codified at 17 C.F.R. § 240.21F-2, effective 60 days after publication in the Federal Register.

34 *Id.*, at 244 (setting forth 17 C.F.R. § 240.21F-2(a), which references the procedures are set forth in § 240.21F-9(a) of the rule).

35 *Id.*, at 244 (setting forth 17 C.F.R. § 240.21F-2(b)(1)(i), (ii)); see n. 30, *supra*, and accompanying text.

36 *Id.*, at 16.

37 *Id.*

38 *Id.*, at 17.

39 *Id*, at 17-18.

40 *Id.*, at 244 (setting forth 17 C.F.R. § 240.21F-2(b)(1)(iii)). To qualify for an award under Section 21F, the rule requires the whistleblower to "submit original information to the Commission in accordance with the procedures and conditions described in 240.21F-4, 240.21F-8, and 240.21F-9[.]" *Id.* (setting forth 17 C.F.R. § 240.21F-2(a(2)).

41 *Id.*, at 18.

42 *Id.*, at 18, n. 39.

43 *Id.*, at 245 (setting forth 17 C.F.R. § 240.21F-2(b)(2)).

44 *Id.*, at 18.

45 *Id.*, at 19-20.

46 No. 10 Civ. 8202(LBS), 2011 WL 1672066 (S.D.N.Y. May 4, 2011).

47 *Id.*, 2011 WL 1672066, at *7. With respect to complying with the latter categories, the court found that the language of Section 21F(h)(A)(iii) only protects disclosures that are explicitly required or protected under the laws enumerated in that subsection, and not just any reports of violations subject to the SEC's jurisdiction. *Id.* at *6.

48 *Id.* at *7.

49 *Id.* at *8.

50 *Id.* at *8-*9.

51 *Id.* at *10.

52 See n. 35-38, *supra*, and accompanying text.

53 See Release No. 34-64545, at 244 (setting forth 17 C.F.R. § 240.21F-2(a)).

54 *Id.* (setting forth 17 C.F.R. § 240.21F-2(a), which references the procedures are set forth in § 240.21F-9(a) of the rule).

55 *Id.* (setting forth 17 C.F.R. § 240.21F-2(b)(1)(iii)).